

Pima County, Arizona

*Pima Health System and Services
Enterprise fund*

2011



For the Fiscal Year Ended June 30, 2011

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Report on Audit of Financial Statements
For the Year Ended June 30, 2011

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Report on Audit of Financial Statements
and Additional Information
June 30, 2011

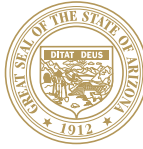
Table of Contents

	Page
INDEPENDENT AUDITORS' REPORT	1 - 2
 FINANCIAL STATEMENTS	
Statement of Net Assets	3
Statement of Revenues, Expenses and Changes in Net Assets	4
Statement of Cash Flows	5 - 6
Notes to Financial Statements	7 - 15
 ADDITIONAL INFORMATION	
Combining Statement of Net Assets by Program	16
Combining Statement of Revenues, Expenses and Changes in Net Assets by Program	17
Combining Statement of Cash Flows by Program	18 - 19
Combining Statement of Net Assets – Long-Term Care Contracts	20
Combining Statement of Revenues, Expenses and Changes in Net Assets – Long-Term Care Contracts	21
Combining Statement of Cash Flows – Long-Term Care Contracts	22 - 23
 ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM CONTRACTS	
Ambulatory Care Contract	
Claims Lag Report - Hospital, Medical and Other – PPC and Prospective	24
Profitability by Risk Group	25
Officers and Directors	26
Arizona Long-Term Care System (ALTCS) Contract	
Claims Lag Report for Propsective Period Only	27
Claims Lag Report for Prior Period Only	28
Utilization Data Report – Contractor Level	29
Sub-capitated Expenses Report	30
Statement of Activities/Income Statement by Contractor	31 - 32
Officers and Directors	33

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Report on Audit of Financial Statements
and Additional Information
June 30, 2011

Table of Contents (Continued)

	Page
GOVERNMENT AUDITING STANDARDS REPORT	
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed In Accordance with <i>Government Auditing Standards</i>	34 - 35
Schedule of Findings and Recommendations	36 - 37
County Response	38 - 39



DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

Independent Auditors' Report

Members of the Arizona State Legislature

The Board of Supervisors of Pima County, Arizona

We have audited the accompanying financial statements of the Pima Health System and Services Enterprise Fund of Pima County as of and for the year ended June 30, 2011, as listed in the table of contents. These financial statements are the responsibility of the Pima Health System and Services Enterprise Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

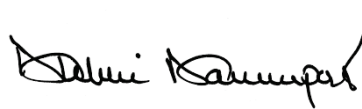
As discussed in Note 1, the Pima Health System and Services Enterprise Fund's financial statements are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the business-type activities and major fund of Pima County that is attributable to the Pima Health System and Services Enterprise Fund. They do not purport to, and do not, present fairly the financial position of Pima County as of June 30, 2011, and the changes in its financial position and, where applicable, its cash flows thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Pima Health System and Services Enterprise Fund as of June 30, 2011, and the changes in its financial position and its cash flows thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note 8, Pima County's contracts with the Arizona Health Care Cost Containment System expired on October 1, 2011. As such, Pima County's management discontinued certain operations of the Fund that include Pima Health System, which stopped providing services as of October 1, 2011. In addition, Pima County sold its Posada del Sol Nursing Home in January 2012.

Our audit was conducted for the purpose of forming an opinion on the financial statements of the Pima Health System and Services Enterprise Fund. The accompanying financial information listed as additional information and Arizona Health Care Cost Containment System contracts in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 26, 2012, on our consideration of the Pima Health System and Services Enterprise Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

A handwritten signature in black ink, appearing to read "Debbie Davenport", with a stylized flourish at the end.

Debbie Davenport
Auditor General

January 26, 2012

FINANCIAL STATEMENTS

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Statement of Net Assets
June 30, 2011

Assets

Current assets:

Cash and cash equivalents	\$ 40,622,855
Receivables:	
Accounts, net	209,645
Reinsurance claims	2,765,753
Grants	1,071,850
Interest	15,334
Due from:	
Medicare	132,104
Other Pima County funds	44,407
Other governments	83,477
Inventory of supplies	91,192
Prepaid expenses	78,260
	<hr/>
Total current assets	45,114,877

Noncurrent assets:

Capital assets:	
Leasehold improvements	906,575
Machinery and equipment	973,328
Intangible	381,100
Accumulated depreciation:	
Leasehold improvements	(681,452)
Machinery and equipment	(872,599)
Intangible	(171,495)
	<hr/>
Capital assets, net	535,457
	<hr/>
Total assets	45,650,334

Liabilities

Current liabilities:

Accounts payable and accrued liabilities	309,582
Accrued medical and health care claims	19,544,470
Accrued employee compensation	1,078,898
Due to:	
Other Pima County funds	599,389
Other governments	39,137
	<hr/>
Total liabilities	21,571,476

Net Assets

Invested in capital assets	535,457
Restricted for health care	23,561,837
Unrestricted (deficit)	(18,436)
	<hr/>
Total net assets	\$ 24,078,858

See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Statement of Revenues, Expenses and Changes in Net Assets
Year Ended June 30, 2011

Operating revenues:

Capitation	\$ 192,790,228
Reinsurance claims	13,024,266
Charges for services	1,837,774
Other	<u>561,349</u>
Total operating revenues	<u>208,213,617</u>

Operating expenses:

Medical and health care claims	175,586,596
Case management (contracted and salaried)	7,464,603
General, fiscal, and administrative services	4,793,537
Depreciation	214,745
Other	<u>8,468,896</u>
Total operating expenses	<u>196,528,377</u>

Operating income	<u>11,685,240</u>
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Nonoperating revenues (expenses):

Grant revenue	4,690,940
Interest income	296,607
Interest expense	(49,715)
Premium tax	(4,098,646)
Gain on sale of capital assets	<u>4,876</u>
Total nonoperating revenues	<u>844,062</u>

Income before transfer	12,529,302
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Transfer out to Pima County General Fund	<u>(4,596,685)</u>
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Increase in net assets	7,932,617
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Net assets, July 1, 2010	<u>16,146,241</u>
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Net assets, June 30, 2011	<u><u>\$ 24,078,858</u></u>
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PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Statement of Cash Flows
Year Ended June 30, 2011

Cash flows from operating activities:

Cash receipts from:

Contractors, patients and other payors	\$ 205,348,417
Other Pima County funds for goods and services	29,316
Miscellaneous operations	2,399,124

Cash payments to:

Providers for health care services	(162,729,131)
Third party claims processor	(7,172,812)
Employees for services	(22,795,631)
Other Pima County funds for goods and services	(5,393,688)

Net cash provided by operating activities	9,685,595
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Cash flows from noncapital financing activities:

Cash transfer out to Pima County General Fund	(4,596,685)
Loans with other Pima County funds	(277,966)
Interest paid on short-term credit	(51,666)
Grant receipts	4,341,329
Premium tax payments	(4,098,646)

Net cash used for noncapital financing activities	(4,683,634)
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Cash flows from capital and related financing activities:

Proceeds from sale of capital assets	4,876
Purchase of capital assets	(32,445)

Net cash used for capital and related financing activities	(27,569)
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Cash flows from investing activities:

Interest on cash and investments	322,865
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Net cash provided by investing activities	322,865
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Net increase in cash and cash equivalents	5,297,257
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Cash and cash equivalents, July 1, 2010	35,325,598
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Cash and cash equivalents, June 30, 2011	\$ 40,622,855
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(continued)

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Statement of Cash Flows
Year Ended June 30, 2011

(continued)

**Reconciliation of operating income to net cash
provided by operating activities:**

Operating income	\$ 11,685,240
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Adjustments to reconcile operating income to net cash provided by operating activities:

Depreciation	214,745
Changes in assets and liabilities:	
Decrease (increase) in assets	
Accounts receivable	216,814
Reinsurance claims receivable	959,631
Due from Medicare	7,578
Due from other governments	(83,477)
Inventory of supplies	(10,060)
Prepaid expenses	158,068
Increase (decrease) in liabilities	
Accounts payable and accrued liabilities	(104,814)
Accrued medical and health care claims	(628,805)
Accrued employee compensation	(1,192,019)
Due to other governments	(1,526,252)
Deferred revenue	(11,054)

Net cash provided by operating activities	\$ <u><u>9,685,595</u></u>
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See accompanying notes to financial statements

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2011

Note 1 - Summary of Significant Accounting Policies

The accounting policies of Pima County (County) and its Pima Health System and Services Enterprise Fund (Fund) conform to U.S. generally accepted accounting principles (GAAP) applicable to governmental units as promulgated by the Governmental Accounting Standards Board (GASB) and the regulatory requirements of the State of Arizona. A summary of the County's significant accounting policies affecting the Fund follows.

A. Reporting Entity

The Fund is accounted for as an enterprise fund of Pima County, Arizona and the ultimate financial accountability for the Fund remains with Pima County. The Fund's management is responsible for overseeing the operations of Pima Health System (the AHCCCS contracts), Posada del Sol Nursing Home, the Grants and Community Services System, and other Pima County programs, whose activities are included in the accompanying financial statements.

The financial statements present only the Pima Health System and Services Enterprise Fund and are not intended to present the balances and activity of Pima County or its business-type activities and enterprise funds. The County and Pima Health System and Services is a contractor with the Arizona Health Care Cost Containment System (AHCCCS) to provide health care services to eligible enrollees of the AHCCCS Ambulatory and Arizona Long-Term Care System (ALTCS) programs. The Ambulatory program provides both inpatient and outpatient medical and nursing services to eligible enrollees of the Ambulatory program. The ALTCS program provides inpatient and outpatient medical and nursing services in addition to managed institutional and home- and community-based long-term care services to eligible enrollees of the ALTCS program. The Fund also provides long-term care services to Posada del Sol Nursing Home residents who are primarily ALTCS enrollees. The Fund receives monthly premiums from AHCCCS for all eligible enrollees under the respective Ambulatory and ALTCS programs.

B. Fund Accounting

The Fund's accounts are maintained in accordance with the principles of fund accounting to ensure that limitations and restrictions on the Fund's available resources are observed. The principles of fund accounting require that the resources be classified for accounting and reporting purposes into funds in accordance with the activities or objectives specified for those resources. Each fund is considered a separate accounting entity, and its operations are accounted for in a separate set of self-balancing accounts that comprise its assets, liabilities, net assets, revenues, and expenses.

The Fund's financial transactions are recorded and reported as an enterprise fund because its operations are financed and operated in a manner similar to private business enterprises. It is the intent of the Pima County Board of Supervisors that the costs (expenses including depreciation) of goods or services provided by the Fund on a continuing basis be financed or recovered primarily through contractual agreements and user charges.

C. Basis of Accounting

Basis of accounting relates to the timing of the measurements made, and determines when revenues and expenses are recognized in the accounts and reported in the financial statements. The financial statements of the Fund are reported using the economic resources measurement focus and are presented on the accrual basis of accounting. Revenues are recognized when earned, and expenses are recognized when a liability is incurred, regardless of the timing of the related cash flows. When both restricted and unrestricted net assets are available to finance Fund expenses, restricted resources are used before unrestricted resources. Inter-fund transactions that would be treated as revenues or expenses if they involved parties external to the County are recorded in the appropriate revenue or expense accounts. Intra-fund transactions within the Fund are eliminated for the financial statement presentation.

Unless in conflict with GASB pronouncements, the Fund follows Financial Accounting Standards Board Statements and Interpretations issued on or before November 30, 1989; Accounting Principles Board Opinions, and Accounting Research Bulletins. The County has chosen the option not to follow FASB statements and interpretations issued after November 30, 1989.

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2011

Note 1 - Summary of Significant Accounting Policies (continued)

D. Basis of Presentation

The financial statements include a statement of net assets; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. A statement of net assets provides information about the assets, liabilities, and net assets of the Fund at the end of the year. Assets and liabilities are classified as either current or non-current. Net assets are classified according to external restrictions or availability of assets to satisfy the Fund's obligations. Invested in capital assets, represents the cost of capital assets, net of accumulated depreciation. Restricted net assets represent grants, contracts, and other resources that have been externally restricted for specific purposes. Unrestricted net assets include all other net assets, including those that have been designated by management to be used for other than general operating purposes.

A statement of revenues, expenses and changes in net assets provides information about the Fund's financial activities during the year. Revenues and expenses are classified as either operating or non-operating, and all changes in net assets are reported, including capital contributions and transfers. Generally, capitation and other charges generated by the Fund for providing health care services are considered to be operating revenues. Other revenues used for health care, such as grants and interest earnings, are not generated from operations and are considered to be non-operating revenues. Operating expenses include the costs of providing health care services, administrative expenses, and depreciation on capital assets. Other expenses, such as interest expense and AHCCCS premium taxes are considered to be non-operating expenses.

A statement of cash flows provides information about the Fund's sources and uses of cash and cash equivalents during the year. Increases and decreases in cash and cash equivalents are classified as operating, non-capital financing, capital and related financing, or investing.

E. Capitation Receipts

The Fund receives from AHCCCS fixed capitation payments, generally in advance, based on certain rates for each AHCCCS member enrolled with the Fund. The Fund is required to provide all covered health care services to their members, regardless of the cost of care. If there are funds remaining, the Fund retains the funds as profit; if the costs are higher than the amount of capitation payments from AHCCCS, the Fund absorbs the loss. The Fund may recover certain losses for those cases eligible for reinsurance payments. Capitation premiums are recognized in accordance with the Fund's contract with AHCCCS.

Capitation is paid prospectively as well as for prior period coverage (PPC). The PPC period is from the first day of the month of application to the time of enrollment with a contracted health plan. The risk under PPC is shared by both the Fund and AHCCCS for the contract year ended September 30, 2011. AHCCCS reconciles the actual PPC medical costs to the PPC capitation paid during the year. The reconciliation limits the contractor's profits and losses to 2%. Except for Title XIX waiver members, effective October 1, 2002, the PPC rates were adjusted and the reconciliation of PPC costs was not performed for the contract year ended September 30, 2003. The PPC reconciliation was reinstated for the contract year ended September 30, 2004 and thereafter. At June 30, 2011, the Fund has \$220,470 of estimated settlement payments due to AHCCCS for the PPC reconciliation for contract years 2010 and 2011. This amount is netted with other amounts due to and from other governments in the accompanying Statement of Net Assets.

Additional capitation payments from AHCCCS include the Home and Community-Based Services (HCBS) Mix reconciliation. The HCBS Mix reconciliation is designed to limit the risk for both the Fund and AHCCCS of placement assumptions utilized in creating capitation rates. When computing capitation rates, AHCCCS assumes a certain percentage of members will be living in an HCBS setting as compared to a nursing facility. The accuracy of this assumption can materially affect the Fund's profitability. At June 30, 2011, the Fund has \$435,837 of estimated settlement payments due to AHCCCS for the HCBS Mix reconciliation for contract year 2011. This amount is netted with other amounts due to and from other governments in the accompanying Statement of Net Assets.

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2011

Note 1 - Summary of Significant Accounting Policies (continued)

F. Reinsurance Receipts

AHCCCS provides a stop-loss reinsurance program for the Fund for partial reimbursement of re-insurable covered medical services incurred for members with an acute medical condition. The program includes a deductible, which varies based on the Fund's enrollment and the eligibility category of the members. AHCCCS reimburses the Fund based on a coinsurance amount for re-insurable covered services incurred above the deductible.

The reinsurance program includes reinsurance reimbursement for covered organ transplantation. The reinsurance program also includes a special catastrophic reinsurance program which covers conditions such as certain traumatic brain injuries and certain blood related disorders. There is no deductible for catastrophic reinsurance cases and AHCCCS reimburses the Fund at a percentage of the Fund's paid amount, less the coinsurance amount, unless the costs are paid under a sub-capitated arrangement. AHCCCS pays 85% (75% for traumatic brain injuries) of the Fund's paid amount up to \$650,000 and 100% thereafter for catastrophic reinsurance. Regular reinsurance provides partial reimbursement of reinsurance eligible covered services and AHCCCS will reimburse 75% of eligible costs above a certain deductible level. The deductible is the responsibility of the program contractor. For transplants, payment is limited to 85% of the AHCCCS contract amount for the transplant services rendered or 85% of the Fund's paid amount, whichever is lower.

Reinsurance claims receivable result from additional payments from the AHCCCS Administration to the Fund for certain enrollees whose qualifying medical expenses paid by the Fund during the year ended June 30, 2011, were in excess of specified deductible limits. Reinsurance claims receivables are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and a credit to reinsurance claims receivable based on its assessment of the current status of individual balances. Balances which are still outstanding after management has used reasonable collection efforts are also written off through a charge to earnings and a credit to reinsurance claims receivable. Reinsurance claims receivable at June 30, 2011 are considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

G. Share of Costs

The Fund's members covered under the ALTCS program that do not meet certain eligibility criteria are required to pay for a portion of the care they receive. AHCCCS reduces the contracted capitation rate with the Fund by the estimated amount of participant shared costs. After contract year end, AHCCCS analyzes the amount that the Fund should have received from members for share of costs. If the Fund receives less money from the participants in payment of their share of the costs than AHCCCS anticipated, AHCCCS reimburses the Fund for the difference. The share of costs receivables are based on contract year which runs from October 1 to September 30. At June 30, 2011, the Fund had approximately \$753,019 due from AHCCCS related to share of costs for contract year 2011. This amount is netted with other accounts due to and from other governments, and is included in the overall amount due from other governments in the accompanying Statement of Net Assets.

Share of cost receivables are based on assumptions and estimates, and while management believes the receivable is reasonable, the ultimate share of cost payment for the 2011 contract year may be less than or in excess of the amount estimated once AHCCCS completes the contract year reconciliation. Management provides for probable uncollectible amounts through a charge to earnings and a credit to the share of cost receivables based on its assessment of the current status of individual balances. Balances which are still outstanding after management has used reasonable collection efforts are also written off through a charge to earnings and a credit to share of costs receivable. Share of costs receivable at June 30, 2011 are considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2011

Note 1 - Summary of Significant Accounting Policies (continued)

H. Grant Revenues

Grants and assistance awards made on the basis of entitlement periods are recorded as grants receivable and revenues when entitlement occurs. Reimbursement grants are recorded as grants receivable and revenues as soon as all eligibility requirements have been met. Funding sources may, at their discretion, request reimbursement for expenses or return of funds, or both, if the Fund does not comply with the terms of the contract.

I. Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, cash in bank, and cash and investments held by the Pima County Treasurer in an investment pool. All investments are stated at fair value.

J. Accounts and Grants Receivable

Accounts receivable consist primarily of amounts due from third-party payers, providers for health care services and recoupment of overpayments to providers. Grants receivable consist primarily of amounts due directly from government agencies or passed through the Pima Council on Aging. These balances are stated at the amount management expects to collect. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual balances. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable.

At June 30, 2011, accounts receivable was net of an allowance for doubtful accounts of \$233,908. Grants receivable at June 30, 2011 are considered by management to be fully collectible and, accordingly, an allowance for doubtful accounts has not been provided.

K. Due To/Due From Other Governments

These amounts consist of amounts due to or from AHCCCS based on contractual agreement provisions of the Ambulatory and ALTCS programs.

L. Inventory of Supplies

Inventories consist of medical supplies and are recorded as assets when purchased and expensed when consumed. These inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method.

M. Capital Assets

Purchased capital assets are capitalized at cost. Donated assets are capitalized at their estimated fair market value on the date received. The Fund capitalizes leasehold improvements and intangibles valued at \$100,000 and above and all machinery and equipment valued at \$5,000 and above. Depreciation of assets is charged as an expense against operations. Assets are depreciated over their estimated useful lives using the straight-line method. The estimated useful lives are as follows:

Leasehold improvements	7-10 years
Machinery and equipment	5-15 years
Intangibles	5 years

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2011

Note 1 - Summary of Significant Accounting Policies (continued)

N. Medical and Health Care Claims Payable

The Fund is responsible for the cost of providing medical services on a fee-for-service basis to a majority of the health care service providers through which it contracts with the exception of two providers that have negotiated sub-capitation agreements. The Fund paid \$32,308 to these sub-capitated providers during fiscal year 2011.

In the accompanying financial statements, medical and health care claims expense includes claims paid, claims in process and pending, and the estimate made by management for incurred but not reported (IBNR) programmatic claims. These IBNR programmatic claims include charges by physicians, hospitals and other health care providers for services rendered to eligible members during the period for which claims have not yet been submitted.

The estimates for IBNR programmatic claims are developed using methods based upon historical data for payment patterns and other relevant factors. Such liabilities are necessarily based on assumptions and estimates, and while management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liability are continually reviewed, and adjustments are reflected in the period determined.

At June 30, 2011, medical and health care claims payable consists of estimates of \$17,009,441 in the ALTCS program, \$1,743,726 in the Ambulatory program and \$791,303 in the Grants and Community Services System.

O. Compensated Absences

Compensated absences consist of vacation leave and a calculated amount of sick leave earned by employees based on services already rendered.

Employees may accumulate up to 240 hours of vacation depending upon years of service, but any vacation hours in excess of the maximum amount that are unused at fiscal year-end are forfeited. Upon termination of employment, all unused and unforfeited vacation benefits are paid to employees. Accordingly, vacation benefits are accrued as a liability in the financial statements.

Employees may accumulate up to 1,920 of sick hours. Generally, sick leave benefits provide for ordinary sick pay and are cumulative but are forfeited upon termination of employment. Sick leave benefits do not vest with employees; however, employees who are eligible to retire from County service into the Arizona State Retirement System, Public Safety Personnel Retirement Plan, or Corrections Officer Retirement Plan may request sick leave be converted to annual leave, on a predetermined conversion basis. An estimate of those retirement payouts is accrued as a liability.

P. Taxes

The Fund is an enterprise fund of Pima County and is not subject to income taxes. However, payments from AHCCCS for acute care, ventilator dependent care, and ALTCS care are subject to a premium tax of 2%. Total premium tax expense for the year ended June 30, 2011 was \$4,098,646 which is included in the non-operating expenses portion of the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. The Fund has \$22,373 due to the Arizona Department of Insurance at June 30, 2011. The Long-Term Care Contracts amount of \$17,659 is netted with other accounts due to and from other governments, and is included in the overall amount due from other governments in the accompanying Statement of Net Assets. The Ambulatory Contracts amount of \$4,714 is included in the Due to other governments in the accompanying Statement of Net Assets.

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2011

Note 1 - Summary of Significant Accounting Policies (continued)

Q. Management's Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at June 30, 2011, and the reported amounts of revenues and expenses during the fiscal year then ended. Actual results may differ from these estimates.

Note 2 - Cash and Investments

Deposits – At June 30, 2011, the County's total cash on hand was \$1,700. The carrying amount of the deposits was \$3,421,041, and the bank balance was \$6,573,706. The County does not have a formal policy with respect to custodial credit risk of deposits. As of June 30, 2011, the cash in bank balance was fully insured by FDIC.

At June 30, 2011, the County's cash and investments in the Pima County Treasurer's Investment pool was \$37,200,114. The cash and investments in the investment pool represent a portion of the County Treasurer's pool portfolio. The pool's structure does not provide for shares. The Fund's portion in the pool is not identified with specific investments. Investment income is allocated to the Fund on a pro-rata basis.

Credit risk – Credit risk is the risk that an issuer or counterparty to an investment will not fulfill its obligations. The County does not have a formal investment policy with respect to credit risk. The Pima County Treasurer's investment pool is unrated.

Interest rate risk – Interest rate risk is the risk that changes in interest rates will adversely affect an investment's fair value. The County does not have a formal investment policy with respect to interest rate risk. The Pima County Treasurer's investment pool had a weighted average maturity of 198 days at June 30, 2011.

Legal provisions – Arizona Revised Statutes authorize the County to invest public monies in the State Treasurer's investment pool; obligations issued or guaranteed by the United States or any of the senior debt of its agencies, sponsored agencies, corporations, sponsored corporations, or instrumentalities; specified state and local government bonds; interest-earning investments such as savings accounts, certificates of deposit, and repurchase agreements in eligible depositories; and specified commercial paper, bonds, debentures, and notes issued by corporations organized and doing business in the United States. In addition, the County Treasurer may invest trust funds in fixed income securities of corporations doing business in the United States or District of Columbia.

Credit risk – Statutes have the following requirements for credit risk:

1. Commercial paper must be of prime quality and rated within the top two ratings by a nationally recognized rating agency.
2. Corporate bonds, debentures, and notes must be rated within the top three ratings by a nationally recognized rating agency.
3. Fixed income securities must carry one of the two highest ratings by Moody's investors service and Standard and Poor's rating service. If only one of the above-mentioned services rates the security, it must carry the highest rating of that service.

Custodial credit risk – Statutes require collateral for deposits and certificates of deposit at 101 percent of all deposits not covered by federal depository insurance.

Concentration of credit risk – Statutes do not include any requirements for concentration of credit risk.

Interest rate risk – Statutes require that public monies invested in securities and deposits have a maximum maturity of 5 years. Investments in repurchase agreements must have a maximum maturity of 180 days.

Foreign currency risk – Arizona Revised Statutes do not allow foreign investments.

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2011

Note 3 - Capital Assets

Capital assets activity for the year ended June 30, 2011 was as follows:

	July 1, 2010			June 30, 2011
	Balance	Increases	Decreases	Balance
Leasehold improvements	\$ 900,824	\$ 5,751		\$ 906,575
Accumulated depreciation	<u>(657,989)</u>	<u>(23,463)</u>		<u>(681,452)</u>
Net leasehold improvements	<u>242,835</u>	<u>(17,712)</u>		<u>225,123</u>
 Machinery and equipment	 1,041,019	 26,693	 \$ (94,384)	 973,328
Accumulated depreciation	<u>(851,922)</u>	<u>(115,061)</u>	<u>94,384</u>	<u>(872,599)</u>
Net machinery and equipment	<u>189,097</u>	<u>(88,368)</u>		<u>100,729</u>
 Intangibles	 381,100			 381,100
Accumulated depreciation	<u>(95,275)</u>	<u>(76,220)</u>		<u>(171,495)</u>
Net intangibles	<u>285,825</u>	<u>(76,220)</u>		<u>209,605</u>
 Capital assets, net	 <u>\$ 717,757</u>	 <u>\$ (182,300)</u>	 <u>\$</u>	 <u>\$ 535,457</u>

Note 4 - Claims, Judgments and Risk Management

Compliance with Laws and Regulations – The Fund is subject to numerous laws, regulations and oversight by the state and federal governments. These laws and regulations include, but are not necessarily limited to, matters such as government health care program participation requirements, reimbursement for member services and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant financial sanctions. Compliance with such laws and regulations can be subject to future review and interpretation as well as regulatory actions unknown at this time.

The Fund has received final notices from AHCCCS of possible sanctions for each quarter, in fiscal year 2011. The sanctions are a result of pended encounters. As of June 30, 2011, there were 58,889 pended encounters with associated sanction amounts of \$975,320. It is unknown whether pended encounters were due to the Fund's or AHCCCS' system issues and AHCCCS has preliminarily waived the monetary sanctions as of June 30, 2011. The sanctions could be re-imposed if the Fund is unable to adjudicate all pended encounters once AHCCCS system issues are corrected. Fund management does not believe these sanctions will be re-imposed.

Self-insurance - The Fund is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; medical malpractice; and natural disasters. The Fund is a participant in Pima County's self-insurance program, and in the opinion of the Fund's management, that self-insurance program would cover any unfavorable outcomes from these risks. Accordingly, the Fund has no risk of loss beyond adjustments to future years' premium payments to Pima County's self-insurance program. All estimated losses for unsettled claims and actions of the Fund are determined on an actuarial basis and are included in the *Pima County Comprehensive Annual Financial Report*. As of June 30, 2011, the Fund incurred \$790,374 in self-insurance expense,

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2011

Note 4 - Claims, Judgments and Risk Management (continued)

of which \$244,214 is included in other operating expenses and \$546,160 in medical and health care claims, in the accompanying Statement of Revenues, Expenses and Changes in Net Assets.

Medical Malpractice - The Fund has obtained modified claims-made insurance policies to cover medical malpractice claims. Deductibles are the responsibility of Pima County through Risk Management and are \$1,000,000 per occurrence with an annual aggregate self insurance retention of \$5,000,000. The Fund's primary medical malpractice policy has a retroactive date of June 26, 1993. Settled claims have not exceeded insurance coverage in any of the prior three fiscal years.

Note 5 - Related Party Transactions

During the course of its operations, the Fund had numerous transactions with other Pima County funds to finance operations and provide services. During the year ended June 30, 2011, the Fund received capitation revenues totaling \$98,317 from Pima County departments for services provided to Pima County patients and other income totaling \$29,316 for claims processing services. The Fund incurred expenses totaling \$5,737,889 for the allocation of overhead, insurance premiums, and other charges for miscellaneous supplies and services from Pima County.

Of the \$599,389 balance in due to other Pima County funds, \$572,688 represents advances received from other County funds to eliminate cash overdrafts in the Fund's following programs:

Grants/Community Services System	\$ 439,042
Other Pima County Programs	133,646
Total	<u>\$ 572,688</u>

The remaining \$26,701 was for miscellaneous services.

Note 6 – Pension and Other Postemployment Benefits

Plan Descriptions—The County contributes to a cost-sharing, multiple-employer defined benefit pension plan; a cost-sharing, multiple-employer defined benefit health insurance premium plan; and a cost-sharing, multiple-employer defined benefit long-term disability plan administered by the *Arizona State Retirement System* (ASRS) that covers employees of the State of Arizona and employees of participating political subdivisions and school districts. Benefits are established by state statute and generally provide retirement, long-term disability, and health insurance premium benefits, including death and survivor benefits. The retirement benefits are generally paid at a percentage, based on years of service, of the retiree's average compensation. Long-term disability benefits vary by circumstance, but generally pay a percentage of the employee's monthly compensation. Health insurance premium benefits are paid as a flat dollar amount per month towards the retiree's health care insurance premiums, in amounts based on whether the benefit is for the retiree or for the retiree and his or her spouse. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of A.R.S. Title 38, Chapter 5, Article 2. The ASRS issues a publicly available financial report that may be obtained by writing or calling:

Arizona State Retirement System
3300 North Central Avenue
P.O. Box 33910
Phoenix, AZ 85067-3910
(602) 240-2000 or 1-800-621-3778

PIMA COUNTY, ARIZONA
Pima Health System and Services - Enterprise Fund
Notes to Financial Statements
June 30, 2011

Note 6 – Pension and Other Postemployment Benefits (continued)

Funding Policy—The Arizona State Legislature establishes and may amend active plan members' and the County's contribution rates. For the year ended June 30, 2011, active ASRS members were required by statute to contribute at the actuarially determined rate of 9.85 percent (9.6 percent for retirement and 0.25 percent for long-term disability) of the members' annual covered payroll and the County was required by statute to contribute at the actuarially determined rate of 9.85 percent (9.01 percent for retirement, 0.59 percent for health insurance premium, and 0.25 percent for long-term disability) of the members' annual covered payroll.

The County's contributions for the current and two preceding years, all of which were equal to the required contributions, were as follows:

Years ended June 30	Retirement Fund	Health Benefit Supplement Fund	Long-Term Disability Fund
2011	\$ 1,210,113	\$ 79,242	\$ 33,577
2010	\$ 1,779,021	\$ 140,786	\$ 85,325
2009	\$ 1,960,018	\$ 235,496	\$ 122,654

Note 7 – Capitation

For the year ended June 30, 2011, capitation revenues consist of the following amounts:

ALTCS long-term care	\$ 189,690,369
AHCCCS ambulatory/acute care	3,099,859
Total	<u>\$ 192,790,228</u>

Note 8 – Subsequent Event

Pima County's contracts with the Arizona Health Care Cost Containment System expired on October 1, 2011. As such, Pima County's management discontinued certain operations of the Fund that included the sale of the county-owned Posada Del Sol Nursing Home effective January 1, 2012.

At June 30, 2012, the County intends to close Pima Health System and Services Enterprise Fund. Assets and liabilities will be liquidated and any remaining financial activity will be reported in the General Fund in Fiscal Year 2012-13. With the appropriate approvals from AHCCCS, any remaining equity will also be transferred to the General Fund.

During this process, the County intends to fully comply with all laws, rules and regulations applicable to the closing of the Fund, specifically including AHCCCS contracts. While completing all required closing activities, an assessment of residual activity will be conducted to assess the costs and benefits of continuing certain residual activities after June 30, 2012. The County will pursue continued and ongoing communication with AHCCCS to facilitate a mutually agreed upon closing process.